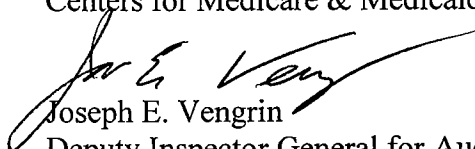


**JUN - 9 2009**

TO: Charlene Frizzera
Acting Administrator
Centers for Medicare & Medicaid Services

FROM: 
Joseph E. Vengrin
Deputy Inspector General for Audit Services

SUBJECT: Review of Termination Claim for Postretirement Benefit Costs Made by CareFirst of Maryland, Incorporated (A-07-09-00299)

Attached is an advance copy of our final report on the termination claim for postretirement benefit (PRB) costs made by CareFirst of Maryland, Incorporated (CareFirst). We will issue this report to CareFirst within 5 business days.

CareFirst administered Medicare Part A and Part B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) beginning July 1, 1966. On December 31, 1994, the Part B contractual relationship was terminated, and on September 30, 2005, the Part A contractual relationship was terminated. Throughout the period of its Medicare contracts, CareFirst accounted for PRB costs using the pay-as-you-go method.

CMS reimburses a portion of its contractors' PRB costs. In claiming PRB costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation (FAR) and applicable Cost Accounting Standards as required by their Medicare contracts. On November 25, 2008, CareFirst submitted a termination claim of \$1,543,972 to seek reimbursement for future PRB costs that it had not incurred prior to the termination of the Medicare contracts.

Our objective was to determine whether CareFirst's termination claim for PRB costs associated with Medicare Part A and B contracts was allowable for Medicare reimbursement.

CareFirst's entire termination claim of \$1,543,972 in PRB costs for Medicare Part A and B contracts was unallowable for Medicare reimbursement. The termination claim was calculated based on a retroactive change in accounting practice without CMS approval. Therefore, and pursuant to CareFirst's Medicare contracts, none of the costs claimed were allowable.

We recommend that CareFirst withdraw its termination claim of \$1,543,972 for PRB costs associated with Medicare Part A and B contracts.

In written comments on our draft report, CareFirst disagreed with our recommendation. CareFirst said that the CMS contracting officer should use his or her discretion “to assure equitable treatment of the contractor” and take into account “the statutorily-imposed requirements of contract which states that the Intermediary not incur a loss.” We maintain that CareFirst should withdraw the full claim amount.

If you have any questions or comments about this report, please do not hesitate to call me, or your staff may contact George M. Reeb, Assistant Inspector General for the Centers for Medicare & Medicaid Audits, at (410) 786-7104 or through e-mail at George.Reeb@oig.hhs.gov or Patrick J. Cogley, Regional Inspector General for Audit Services, Region VII, at (816) 426-3591 or through e-mail at Patrick.Cogley@oig.hhs.gov. Please refer to report number A-07-09-00299.

Attachment



DEPARTMENT OF HEALTH & HUMAN SERVICES

Office of Inspector General
Offices of Audit Services

JUN 12 2009

Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

Report Number: A-07-09-00299

Mr. Emery Hill
Manager, External Audit Coordination
CareFirst of Maryland, Incorporated
10455 Mill Run Circle
Owings Mills, Maryland 21117

Dear Mr. Hill:

Enclosed is the U.S. Department of Health and Human Services (HHS), Office of Inspector General (OIG), final report entitled "Review of Termination Claim for Postretirement Benefit Costs Made by CareFirst of Maryland, Incorporated." We will forward a copy of this report to the HHS action official noted on the following page for review and any action deemed necessary.

The HHS action official will make final determination as to actions taken on all matters reported. We request that you respond to this official within 30 days from the date of this letter. Your response should present any comments or additional information that you believe may have a bearing on the final determination.

Pursuant to the Freedom of Information Act, 5 U.S.C. § 552, OIG reports generally are made available to the public to the extent that information in the report is not subject to exemptions in the Act. Accordingly, this report will be posted on the Internet at <http://oig.hhs.gov>.

If you have any questions or comments about this report, please do not hesitate to call me at (816) 426-3591, or contact Jenenne Tambke, Audit Manager, at (573) 893-8338, extension 21, or through e-mail at Jenenne.Tambke@oig.hhs.gov. Please refer to report number A-07-09-00299 in all correspondence.

Sincerely,

Patrick J. Cogley
Regional Inspector General
for Audit Services

Enclosure

Direct Reply to HHS Action Official:

Ms. Deborah Taylor
Acting Director
Office of Financial Management
Centers for Medicare & Medicaid Services
Mail Stop C3-01-24
7500 Security Boulevard
Baltimore, Maryland 21244-1850

Department of Health and Human Services

**OFFICE OF
INSPECTOR GENERAL**

**REVIEW OF TERMINATION CLAIM
FOR POSTRETIREMENT BENEFIT
COSTS MADE BY CAREFIRST OF
MARYLAND, INCORPORATED**



Daniel R. Levinson
Inspector General

June 2009
A-07-09-00299

Office of Inspector General

<http://oig.hhs.gov>

The mission of the Office of Inspector General (OIG), as mandated by Public Law 95-452, as amended, is to protect the integrity of the Department of Health and Human Services (HHS) programs, as well as the health and welfare of beneficiaries served by those programs. This statutory mission is carried out through a nationwide network of audits, investigations, and inspections conducted by the following operating components:

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The Office of Audit Services (OAS) provides auditing services for HHS, either by conducting audits with its own audit resources or by overseeing audit work done by others. Audits examine the performance of HHS programs and/or its grantees and contractors in carrying out their respective responsibilities and are intended to provide independent assessments of HHS programs and operations. These assessments help reduce waste, abuse, and mismanagement and promote economy and efficiency throughout HHS.

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The Office of Evaluation and Inspections (OEI) conducts national evaluations to provide HHS, Congress, and the public with timely, useful, and reliable information on significant issues. These evaluations focus on preventing fraud, waste, or abuse and promoting economy, efficiency, and effectiveness of departmental programs. To promote impact, OEI reports also present practical recommendations for improving program operations.

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Notices

THIS REPORT IS AVAILABLE TO THE PUBLIC
at <http://oig.hhs.gov>

Pursuant to the Freedom of Information Act, 5 U.S.C. § 552, Office of Inspector General reports generally are made available to the public to the extent that information in the report is not subject to exemptions in the Act.

OFFICE OF AUDIT SERVICES FINDINGS AND OPINIONS

The designation of financial or management practices as questionable, a recommendation for the disallowance of costs incurred or claimed, and any other conclusions and recommendations in this report represent the findings and opinions of OAS. Authorized officials of the HHS operating divisions will make final determination on these matters.

EXECUTIVE SUMMARY

BACKGROUND

CareFirst of Maryland, Incorporated (CareFirst), administered Medicare Part A and Part B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) beginning July 1, 1966. On December 31, 1994, the Part B contractual relationship was terminated, and on September 30, 2005, the Part A contractual relationship was terminated. Throughout the period of its Medicare contracts, CareFirst accounted for postretirement benefit (PRB) costs using the pay-as-you-go method.

CMS reimburses a portion of its contractors' PRB costs. In claiming PRB costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation (FAR) and applicable Cost Accounting Standards as required by their Medicare contracts. On November 25, 2008, CareFirst submitted a termination claim of \$1,543,972 to seek reimbursement for future PRB costs that it had not incurred prior to the termination of the Medicare contracts.

OBJECTIVE

Our objective was to determine whether CareFirst's termination claim for PRB costs associated with Medicare Part A and B contracts was allowable for Medicare reimbursement.

SUMMARY OF FINDING

CareFirst's entire termination claim of \$1,543,972 in PRB costs for Medicare Part A and B contracts was unallowable for Medicare reimbursement. The termination claim was calculated based on a retroactive change in accounting practice without CMS approval. Therefore, and pursuant to CareFirst's Medicare contracts, none of the costs claimed were allowable.

RECOMMENDATION

We recommend that CareFirst withdraw its termination claim of \$1,543,972 for PRB costs associated with Medicare Part A and B contracts.

AUDITEE COMMENTS AND OFFICE OF INSPECTOR GENERAL RESPONSE

In written comments on our draft report, CareFirst disagreed with our recommendation. CareFirst said that the CMS contracting officer should use his or her discretion "to assure equitable treatment of the contractor" and take into account "the statutorily-imposed requirements of contract which states that the Intermediary not incur a loss." CareFirst's comments are included in their entirety as the Appendix.

We maintain that CareFirst should withdraw the full claim amount. We held to the FAR provisions when determining that CareFirst's unallowable PRB claim represented a request for reimbursement of unallowable costs.

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INTRODUCTION

BACKGROUND

CareFirst of Maryland, Incorporated (CareFirst), administered Medicare Part A and Part B operations under cost reimbursement contracts with the Centers for Medicare & Medicaid Services (CMS) beginning July 1, 1966. On December 31, 1994, the Part B contractual relationship was terminated, and on September 30, 2005, the Part A contractual relationship was terminated. Throughout the period of its Medicare contracts, CareFirst accounted for the postretirement benefit (PRB) costs associated with Medicare Part A and B contracts using the pay-as-you-go method.

CMS reimburses a portion of its contractors' PRB costs. In claiming PRB costs, contractors must follow cost reimbursement principles contained in the Federal Acquisition Regulation (FAR) and applicable Cost Accounting Standards as required by their Medicare contracts.

The Medicare contracts require that costs be estimated (budgeted), accumulated, and reported on a consistent basis and that any change in accounting practice be submitted to CMS in advance. Furthermore, the FAR sets forth the allowability requirements and the three methods of accounting for PRB costs that are permitted under a Government contract.

On November 25, 2008, CareFirst submitted a termination claim of \$1,543,972 to seek reimbursement for future PRB costs that it had not incurred prior to the termination of the Medicare contracts.

OBJECTIVE, SCOPE, AND METHODOLOGY

Objective

Our objective was to determine whether CareFirst's termination claim for PRB costs associated with Medicare Part A and B contracts was allowable for Medicare reimbursement.

Scope

At the request of CMS, we audited the PRB termination claim of \$1,543,972 that CareFirst submitted for the Medicare Part A and B contracts' PRB costs. Achieving our objective did not require that we review CareFirst's overall internal control structure. However, we reviewed the internal controls related to the PRB termination claim to determine whether the claim was allowable in accordance with the FAR.

Methodology

We examined CareFirst's PRB claim in relation to applicable laws, regulations, and other Federal requirements. We also reviewed information presented in CareFirst's Termination Cost Voucher, which included support prepared by CareFirst's consulting actuaries.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our finding and conclusions based on our audit objective.

FINDING AND RECOMMENDATION

CareFirst's entire termination claim of \$1,543,972 in PRB costs for Medicare Part A and B contracts was unallowable for Medicare reimbursement. The termination claim was calculated based on a retroactive change in accounting practice without CMS approval. Therefore, and pursuant to CareFirst's Medicare contracts, none of the costs claimed were allowable.

FEDERAL REQUIREMENTS

FAR 31.205-6(o) sets forth the requirements and applicable methods of accounting for PRB costs under a Government contract. PRB costs may include, but are not limited to, postretirement health care; life insurance provided outside a pension plan; and other welfare benefits, such as tuition assistance, daycare, legal services, and housing subsidies provided after retirement. PRB costs do not include retirement income and ancillary benefits, such as life insurance, that pension plans pay following employees' retirement.

FAR 31.205-6(o)(2) requires contractors to use one of three methods for measuring and assigning PRB costs to accounting periods:

- The cash basis (or pay-as-you-go) method recognizes PRB costs when they are paid.
- The terminal funding method recognizes the entire PRB liability as a lump-sum payment upon termination of employees. The lump-sum payment must be remitted to an insurer or trustee for the purpose of providing PRBs to retirees and is allowable if amortized over 15 years.
- The accrual method measures and assigns costs according to generally accepted accounting principles and pays costs to an insurer or trustee to establish and maintain a fund or reserve for the sole purpose of providing PRBs to retirees. The accrual must be calculated in accordance with generally accepted actuarial principles and practices as promulgated by the Actuarial Standards Board.

The Medicare contract, Appendix B, section II(A), requires that costs be estimated (budgeted), accumulated, and reported on a consistent basis. In addition, CMS issued to Medicare contractors the "Budget and Performance Requirements" (BPR), section VI(B), which states that "as regards the allocation of such costs to the Medicare contract/agreement . . . [a]ny change in accounting practice for such pension and/or post-retirement benefit costs must be submitted to CMS in advance for approval." The BPR further defines a change in accounting practice to include "a change from cash (pay-as-you-go) accounting to accrual accounting" In response to our prior reviews of PRB termination claims, CMS agreed that the Medicare

contracts do not permit retroactive changes in accounting practices without advance CMS approval; accordingly, CMS issued cost disallowances on that basis.

UNALLOWABLE TERMINATION CLAIM

On December 31, 1994, CareFirst's Medicare Part B contractual relationship was terminated, and on September 30, 2005, its Medicare Part A contractual relationship was terminated. On November 25, 2008, CareFirst submitted a termination claim of \$1,543,972 to seek reimbursement for future PRB costs that CareFirst had not recognized prior to the termination of the Medicare contracts.

Throughout the entire period of its Medicare contracts, CareFirst claimed PRB costs for Medicare Part A and B contracts using the pay-as-you-go method. By selecting this method, CareFirst signified that, pursuant to the FAR and its Medicare contracts, it would be reimbursed only for actual paid claims during each year.

CareFirst based its termination claim for PRB costs on a retroactive change in its contract cost accounting practice from the pay-as-you-go method to the accrual method. CareFirst did not obtain CMS approval before making this change, as required by the BPR. Therefore, CareFirst's claimed reimbursement for \$1,543,972 in PRB costs was unallowable.

RECOMMENDATION

We recommend that CareFirst withdraw its termination claim of \$1,543,972 for PRB costs associated with Medicare Part A and B contracts.

AUDITEE COMMENTS

In written comments on our draft report, CareFirst disagreed with our recommendation. Citing FAR 49.201, CareFirst said that "... the [CMS] Contracting Officer should exercise business judgment to ensure that the contractor is made whole, which in this case means taking into account the statutorily-imposed requirements of contract which states that the Intermediary not incur a loss." CareFirst added that it would refund any pension surplus agreed upon during the final settlement process. CareFirst's comments are included in their entirety as the Appendix.

OFFICE OF INSPECTOR GENERAL RESPONSE

We maintain that CareFirst should withdraw the full claim amount. With respect to CareFirst's statement regarding FAR 49.201, we acknowledge that both the FAR and relevant statutes support the general principle that the CMS contracting officer has the authority to use business judgment in addressing and compromising contract claims. However, this authority, in our view, cannot be read to override provisions of the contract, CMS's BPR guidance, and the FAR regarding allocating and accounting for PRB costs. We held to these provisions when determining that CareFirst's unallowable PRB claim represented a request for reimbursement of unallowable costs.

APPENDIX

William V. Stack
Vice President and
Corporate Controller

CareFirst BlueCross BlueShield
10455 Mill Run Circle
Owings Mills, MD 21117-4208
Tel: 410-998-7011
Fax: 410-998-6850
Cellular 410-218-6634
E-mail: bill_stack@carefirst.com



April 17, 2009

Office of the Inspector General
Office of Audit Services
Department of Health and Human Services
Region VII
601 East 12th Street
Room 284A
Kansas City, Missouri 64106

Re: Audit Report A-07-09-00299

Dear Mr. Cogley:

CareFirst of Maryland, Inc., d/b/a CareFirst BlueCross BlueShield ("CareFirst") submits this letter as its response to the above referenced draft report entitled "Review of Termination Claim for Postretirement Benefit Costs Made by CareFirst of Maryland, Incorporated" (the "Draft Report").

The Draft Report recommends that CareFirst withdraw its termination claim of \$1,543,972 for postretirement benefit costs associated with Medicare Part A and B contracts. CareFirst disagrees with this recommendation.

CareFirst has always maintained a Post Retirement Benefit (PRB) program for its employees, including the employees of its Medicare segment. The PRBs include certain medical, dental and life insurance benefits for its retired employees. The benefits extend to covered retirees, covered spouses and covered dependents. CareFirst has and will continue to pay for these benefits past termination. A central concept of termination proceedings is that the Contracting Officer should exercise business judgment to assure equitable treatment of the contractor. Specifically, FAR 49.201 provides as follows:

- (a) A settlement should compensate the contractor fairly for the work done and the preparations made for the terminated portions of the contract, including a reasonable allowance for profit. Fair compensation is a matter of judgment and cannot be measured exactly. In a given case, various methods may be equally appropriate for arriving at fair compensation. The use of business judgment, as distinguished from strict accounting principles, is the heart of a settlement.

(b) The primary objective is to negotiate a settlement by agreement. The parties may agree upon a total amount to be paid the contractor without agreeing on or segregating the particular elements of costs or profit comprising this amount.

(c) Costs and accounting data may provide guides, but are not rigid measures, for ascertaining fair compensation. In appropriate cases, costs may be estimated, differences compromised, and doubtful questions settled by agreement. Other types of data, criteria, or standards may furnish equally reliable guides to fair compensation. The amount of recordkeeping, reporting, and accounting related to the settlement of terminated contracts should be kept to a minimum compatible with the reasonable protection of the public interests.

Applying the principles of FAR 49.201, the Contracting Officer should exercise business judgment to ensure that the contractor is made whole, which in this case means taking into account the statutorily-imposed requirements of contract which states that the Intermediary not incur a loss. As of January 1, 2006, CareFirst has determined that its post retirement benefits liability is \$1,543,972. CareFirst believes that this PRB liability should be offset against the pension surplus in calculating the remaining amount of pension surplus due to the Government. CareFirst will refund any pension surplus that the parties agree is appropriate in connection with the final settlement process.

If you have any questions regarding this response, please contact me at (410) 998-7011.

Sincerely,



William V. Stack
Vice President and Corporate Controller